

Before the
Federal Communications Commission
Washington, D.C. 20554

RECEIVED ORIGINAL
JUN 16 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)

Implementation of Sections of the)
Cable Television Consumer)
Protection and Competition Act of)
1992)

Rate Regulation)

MM Docket No. 92-266

TO: The Commission

OPPOSITION OF DISCOVERY COMMUNICATIONS, INC.

Judith A. McHale
Senior Vice President and
General Counsel

DISCOVERY COMMUNICATIONS, INC.
7700 Wisconsin Ave.
Bethesda, MD 20814

Philip V. Permut
William B. Baker
Michael K. Baker
of

WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000

Its Attorneys

June 16, 1994

No. of Copies rec'd
List A B C D E

0711

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION AND SUMMARY	2
II. THE GOING-FORWARD RULES FAIL TO RESTORE MARKETPLACE INCENTIVES FOR PROGRAMMING INVESTMENT	3
III. THE COMMISSION SHOULD SUBSTANTIALLY INCREASE THE INCENTIVES FOR INVESTMENT IN PROGRAMMING IN A NEUTRAL MANNER	5
IV. BELL ATLANTIC'S PREMISE SUGGESTING THAT THE COMMISSION APPLY TO THE CABLE INDUSTRY AFFILIATE TRANSACTION RULES CREATED FOR THE TELEPHONE INDUSTRY IS FUNDAMENTALLY FLAWED	6
V. CONCLUSION	10

Before the
Federal Communications Commission
Washington, D.C. 20554

RECEIVED
JUN 16 1994
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of)
)
Implementation of Sections of the)
Cable Television Consumer) MM Docket No. 92-266
Protection and Competition Act of)
1992)
)
Rate Regulation)

TO: The Commission

OPPOSITION OF DISCOVERY COMMUNICATIONS, INC.

Discovery Communications, Inc. ("Discovery"), by its attorneys, hereby submits its opposition to petitions for reconsideration of the Commission's Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking in MM Docket No. 92-266.¹

This Opposition responds to two central issues raised by petitioners in this proceeding. First, while Discovery fully supports the FCC's attempts to restore marketplace incentives for cable operator investment in program services, the Commission's rules should be modified to provide substantially greater incentives in an even-handed fashion that allows the relative success of various program services to be determined by subscriber preferences rather than regulations. Second,

¹ Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Fourth Report and Order and Second Order on Reconsideration in MM Docket No. 92-266, FCC 94-38 (rel. March 30, 1994) ("Fourth Report and Order").

Discovery opposes Bell Atlantic's petition for reconsideration, which urges the Commission -- in the name of "regulatory parity" -- to apply to the cable industry, among other things, the affiliate transaction rules developed to address abuses in the much different context of the telephone industry.

I. INTRODUCTION AND SUMMARY

The Commission's Fourth Report and Order establishes a "going-forward" methodology for adjusting regulated rates when channels are added to regulated tiers. Under this scheme, operators are permitted a nominal "network cost adjustment" that, by the Commission's account, covers the costs of adding a channel, as well as a 7.5% mark-up on new programming expenses. Together, these measures are designed to "help promote the growth and diversity of cable programming services." Fourth Report and Order at ¶ 246. A number of programming interests, however, have petitioned the Commission to strengthen the incentives for programming investment, arguing that the current scheme is simply inadequately remunerative to attain the FCC's asserted goal.²

² See Comments of the Times Mirror Company at 1-7; Petition for Reconsideration of Eternal Word Television at 2-6; Petition for Reconsideration of Viacom International Inc. at 1-7; Petition for Clarification or Partial Reconsideration of the Office of the Commissioner of Baseball at 1-3; Petition for Expedited Reconsideration of Public Interest Petitioners at 1-16; Petition of United Video for Reconsideration at 8; Comments of Programming Providers at 1-13; Comments of C-SPAN and C-SPAN 2 in MM Docket No 92-266 (June 7, 1994) at 2-10.

Discovery submits this Opposition to (1) voice its support for the overwhelming majority of petitioners who have persuasively argued that the Commission's incentives are insufficient; and (2) encourage the Commission to adopt enhanced incentives that, while responding to petitioners' legitimate concerns, do not favor any one category of program services over another, but rather universally restore incentives for investment in program services in an unbiased way.

Discovery also opposes Bell Atlantic's petition for reconsideration which seeks to apply identical regulations to all aspects of the telephone and cable industries. Bell Atlantic's approach both ignores fundamental differences between the industries and would undermine the 1992 Cable Act's goal of promoting high quality programming, and it therefore should be rejected.

II. THE GOING-FORWARD RULES FAIL TO RESTORE MARKETPLACE INCENTIVES FOR PROGRAMMING INVESTMENT

The rules governing the addition of channels and mark-up of programming expenses are inadequate to restore marketplace incentives for investment in program services. While the Commission's adoption of these two measures commendably acknowledges the fact that investment in programming is comprised of two important elements -- addition of new program services and continued investment in the quality of services already carried

-- Discovery submits that each measure falls far short of the desired goal of resurrecting marketplace investment incentives.

The Commission's 7.5% mark-up on new programming expense is woefully deficient if operators are to continue to support programmers' efforts to provide a high-quality product. The Commission, in its attempts to ensure that cable rates are reasonable, has significantly undervalued the importance to cable subscribers of high-quality programming.³ Irrespective of whether the program service is relatively "low-cost" or "high-cost," a 7.5% mark-up is not sufficient to ensure operators' continued role in the viability and vitality of the programming marketplace.

Similarly, the Commission's paltry network cost-adjustment of what will often be one penny for the non-programming costs associated with the addition of channels obviously is insufficient to compensate operators for their full costs, much less encourage operators to invest in new programming. The addition of a new channel to a cable system requires that the operator incur not only additional license fees, but also other promotional, marketing and administrative costs entailed in the

³ Indeed, the FCC, in adopting cost-of-service rules, arrived at an overall rate of return on regulated cable service of 11.25% -- a return that is too low. It defies common sense, as well as marketplace realities, to declare that programming -- the heart and soul of cable service -- is entitled to even less of a return than the low 11.25% adopted for every other element of cable service.

launch of a channel. Thus, the network cost adjustment, like the mark-up on programming expenses, must be dramatically increased.

**III. THE COMMISSION SHOULD SUBSTANTIALLY INCREASE THE
INCENTIVES FOR INVESTMENT IN PROGRAMMING IN A NEUTRAL
MANNER**

For the reasons discussed above, the FCC should significantly enhance the incentives for investment in program services. These incentives, however, must be augmented in a fashion that is program service-neutral. The range of programming interests seeking reconsideration of the Commission's going-forward rules includes no-cost program services, low-cost program services, new program services, and existing, widely carried services. While Discovery wholly concurs with these petitioners as to the need for increased incentives, Discovery urges the FCC to augment the incentives in a way that allows the programming marketplace -- rather than FCC rules -- to determine the relative merits, and ultimate success, of competing program services. The viability of programming should be left to marketplace forces, which will continue to reliably determine the success and failure of programming based on subscriber needs and interests.

IV. BELL ATLANTIC'S PREMISE SUGGESTING THAT THE COMMISSION APPLY TO THE CABLE INDUSTRY AFFILIATE TRANSACTION RULES CREATED FOR THE TELEPHONE INDUSTRY IS FUNDAMENTALLY FLAWED

In its petition for reconsideration, Bell Atlantic renews its ongoing quest to apply identical regulations to all aspects of the telephone and cable industries despite the significant historical, structural, and operational differences between the two industries. Discovery submits that the automatic application of rules adopted in the common carrier context to the cable industry not only would ignore relevant fundamental differences between the industries, but also would undermine a major goal of the 1992 Cable Act -- the promotion of high quality programming at reasonable rates.⁴

The Commission already has determined that "[t]elephone companies have failed to advance a sufficient reason why we should adopt as an overriding policy goal achieving regulatory parity,"⁵ and that its regulations for the respective industries should be based on factors relevant to each industry. Bell

⁴ Both Congress and the FCC have recognized the importance of programming. The Commission properly has sought to ensure that its rate regulations do not inadvertently harm existing programmers or inhibit investment in new program services. See, e.g., First Order on Reconsideration, Second Report and Order and Third Notice of Proposed Rulemaking, 9 FCC Rcd 1164, 1228 (1993) ("[W]e attach great importance at this stage of rate regulation to the continued growth of programming.").

⁵ First Order on Reconsideration in MM Docket No. 92-266, FCC 93-428 (rel. Aug. 27, 1993) at ¶ 90.

Atlantic's petition adds nothing to warrant a change in this approach and thus should be rejected. Indeed, as demonstrated more fully below, the affiliate transaction rules provide a most compelling example of why such "parity" would be inappropriate and contrary to the public interest.

The Commission has adopted rules governing the accounting of transactions between affiliated cable operators and programmers that will apply to cable operators "who either elect cost-of-service regulation or seek to adjust benchmark/price cap rates for affiliated programming cost."⁶ Cable operators subject to these rules would be "required to apply valuation methods that are similar to those telephone companies are now "required to apply."⁷ These include a "prevailing company price" policy for cable operators to use in valuing transactions with affiliates that also sell the same kind of asset to a substantial number of third parties.⁸ In addition, the Commission has sought further comment on whether even more stringent rules under consideration in the telephone context should apply to cable as well.⁹

⁶ First Report and Order at ¶ 262.

⁷ Id.

⁸ The affiliate transaction rule adopted by the Commission equates the sale of programming with the sale of an asset. Id. at ¶ 267. When an affiliate sells an asset to a cable operator, the "assets shall be valued at the [affiliate's] prevailing company price, if the provider has sold the same kind of asset to a substantial number of third parties at a generally available price." Id. at ¶ 263.

⁹ Id. at ¶ 310.

Discovery believes that the current cable affiliate transaction rules would pose a real threat to the public interest by possibly impeding legitimate business transactions that are fundamental to the well-being of cable programmers and, in turn, the quality of programming offered to the public. The threat is created by woodenly applying rules developed for one industry to another quite different industry when there are significant distinctions between the two industries.

As an initial matter, the incentives for programmers are wholly distinct from those of traditional telephone company affiliates. Historically, abuses in the common carrier area occurred because the affiliated entity, typically a wholly-owned subsidiary, was established primarily to serve a captured market -- an affiliated carrier.¹⁰ Outside sales, if not refused, were secondary to the affiliate's business plan. This was the pattern not only in the events leading to the divestiture of AT&T, but also more recently in the NYNEX/MECO scandal.¹¹ To preclude improper cross-subsidization, the Commission therefore needed to devise restrictive rules to govern such relationships.

¹⁰ Typically, a regulated entity would create a corporate affiliate designed to provide goods or services on an unregulated basis, a relationship which presented opportunities for abuse. In contrast, cable industry program services often originated entirely independently of cable operators, and only later would a corporate affiliation be established.

¹¹ See New York Tel. Co. and New England Tel. Co. Violations of Commission's Rules, 5 FCC Rcd 5892 (1990).

In contrast, the cable programmer affiliate stands in a quite different posture. Its primary goal is not to serve its affiliate, but to maximize distribution and viewership. This is especially true for services, like The Discovery Channel, which derive significant revenue from advertising. Sales to affiliates, in these instances, are merely incidental to, and a necessary by-product of, the need to maximize distribution. Therefore, the unique incentives facing programming affiliates do not raise the same concerns as are present in the telephone context.

Moreover, public policy considerations present in the cable industry, but absent in the telephone business, cast doubt on the wisdom of having cable affiliate transaction rules at all. Most notable of these is the fact that cable operators historically have, to a significant degree, provided crucial financial support to programmers at critical times in their development. On numerous occasions, cable operators contributed much-needed financing to ensure the viability of a program service.

Discovery's own existence is a prime example of this phenomenon. Without repeating Discovery's early struggles for survival in detail here, suffice it to say that without the financial support of several cable operators, it is unlikely that Discovery would have evolved into the highly acclaimed service that it is today. Other programmers similarly owe their current existence to financial support from cable operators.

The Commission must ensure that programmers are not deprived of a traditional and major source of financing, particularly at this time of fundamental change in the industry. Applying affiliate transaction rules designed for common carriers to the sale of cable programming may, unintentionally, have the adverse effect of constraining the incentives for cable operators to invest in existing and new program services. This could well force programmers to seek more costly outside financing (which will, in the end, increase the cost and/or reduce the quality of the programming). It also could increase the pressure on cable operators to move affiliated programming to à la carte offerings -- which advertiser-supported program services would regard as undesirable. Neither result would serve the public interest.

Given the above, Bell Atlantic's proposal to apply the identical affiliate transaction rules to the cable and telephone industries is flawed. Simplistic notions of "regulatory parity" ignore the more compelling principle that differently situated industries should be regulated differently.

V. CONCLUSION


For the foregoing reasons, Discovery respectfully requests that the Commission take additional steps to restore incentives for investment in programming in a content and program-neutral fashion. In addition, Discovery submits that the Commission should deny the Bell Atlantic petition for reconsideration.

There is no reason to apply affiliate transaction rules developed to rectify abuses in the telephone industry to the cable industry, where application of such rules could have an unintended adverse impact on programming.

Respectfully submitted,
DISCOVERY COMMUNICATIONS, INC.

Judith A. McHale
Senior Vice President and
General Counsel

DISCOVERY COMMUNICATIONS, INC.
7700 Wisconsin Ave.
Bethesda, MD 20814

By: 
Philip V. Permut
William B. Baker
Michael K. Baker
of
WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000

Its Attorneys

June 16, 1994

CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of June, 1994, I caused copies of the foregoing "Opposition of Discovery Communications, Inc." to be mailed via first-class postage prepaid mail to the following:

Everett C. Parker
Henry Geller
Public Interest Petitioners
1750 K Street, 8th Floor
Washington, DC 20006

Jeff Treeman, President
United Video
7140 S. Lewis Road
Tulsa, OK 74136-5422

Howard J. Barr, Esq.
L. Charles Keller, Esq.
Pepper & Corazzini
200 Montgomery Building
1776 K. Street, N.W.,
Suite 200
Washington, D.C. 20006

Edward Schor, Esq.
Senior Vice President
General Counsel/Communications
Viacom International Inc.
1515 Broadway
New York, NY 10036

Richard E. Wiley, Esq.
Philip V. Permut, Esq.
Peter D. Ross, Esq.
Michael K. Baker, Esq.
Wiley, Rein & Fielding
1776 K Street, N.W.
Washington, D.C. 20006

Michael E. Glover
1710 H Street, N.W.
Washington, D.C. 20006

Thomas J. Ostertag, Esq.
Christopher S. Tully, Esq.
Office of the Commissioner of
Baseball
350 Park Avenue
New York, NY 10022

Anthony S. Harrington, Esq.
Robert Corn-Revere, Esq.
Jacqueline P. Cleary, Esq.
Hogan & Hartson L.L.P.
555 13th , N.W.
Washington, D.C. 20004

William T. Lake, Esq.
William R. Richardson, Esq.
Jacquelyn Ruff, Esq.
W. Kenneth Feree, Esq.
Wilmer, Cutler & Pickering
2445 M Street, N.W.
Washington, D.C. 20037

Norman M. Sinel, Esq.
Patrick J. Grant, Esq.
Stephanie M. Phillipps, Esq.
William E. Cook, Jr., Esq.
Arnold & Porter
1200 New Hampshire Avenue,
N.W.
Washington, D.C. 20036



Rede Green